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PETITION FOR CERTIONARI

TO THE

SUPREME COURT OF THE UNITED STATES

No. ~~1051~~ 71-758

A..L. WASSON and Wife, MATTIE PALLMEYER WASSON,

Petitioners,

versus

UNITED STATES OF AMERICA

RESPONDENT

Appeal from the Fifth Circuit Court of Appeals

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PETITION FOR CERTIORARI

OPINIONS BELOW

The findings of fact (R. 209-213), and conclusions of law (R. 214-216) of the District Court are not officially reported but may be found in 56-2 USTC No. 9886. The opinion of the Fifth Circuit Court of Appeals is reported at 250 F.2d 826, and unofficially at 58-1 USTC No. 9176

JURISDICTION

This Petition is for the review of federal income tax matters. The judgment of the Fifth Circuit Court of Appeals sought to be reviewed was dated and entered on January 7, 1958. Motion for Rehearing was denied on February 28,1958. The jurisdiction of this Court is invoked under the provisions of 28 U. S. C. Section 1254.

QUESTIONS PRESENTED

1. Whether or not a partner is entitled to a deduction for sheep purchases on his individual return, where it is found as a fact that sheep of the parnership were sold to the partner, which sale was unrecorded on the partnership books, and it is also found as a fact that such sheep were included in the partner's inventory on his individual tax return? The figures before this Court include partnership income from this unrecorded transfer and the inventory figures on the taxpayer-partner's tax return were found by the District Court to include these sheep transferred. (R. 215, Conclusion 6)

2. Whether or not a taxpayer is entitled to adjustments

to make his income conform to a cash basis of accounting where certain deductions have been disallowed to him on the grounds that he is on the cash basis of accounting rather than the accrual basis of accounting?

3. Whether or not contributions are properly a part of a net operating loss carryback?

4. Whether or not the Trial Court erred in not permiting the taxpayer to offer evidence on cost depletion?

5. Whether or not the adjustment of capital gains and losses should include any adjustment of a capital loss carry-over in connection with carrying back a net operating loss? Stated differently the question is whether or not Section 117 (e) items are within Section 122 (d) (4).

STATUTES AND REGULATIONS INVOLVED

The pertinent statutes and Treasury Regulations are set forth in the Appendix, infra.

STATEMENT OF CASE

FACTS RELATIVE TO QUESTION 1. (Additional deduction of $5,924.00 involved)

The trial Court found as a fact that there was an unrecorded transfer of partnership sheep to Petitioner (Finding 14, R.212), **and of this finding petitioner is not here making any complaint.** As a result of such unrecorded transfer the Respondent has increased partnership sales. The Trial Court goes on to point out in such Finding that such sheep were included in the final

inventory of the taxpayer. The conclusion to the effect that such inclusion in final inventory makes no difference in the personal income of the taxpayer is the error of which Petitioners complain. (Conclusion 6, R. 215)

FACTS RELATIVE TO QUESTION 2. (Additional deduction of $26,251.20 involved)

The Trial Court found as a fact that Petitioner and Wasson and Carter, a partnership of which Petitioner was a member were on the cash receipts and disbursements method of accounting. (R. 211) Based on this finding the Court properly concludes that certain deductions were properly disallowed by the Respondent (R. 214). However, there is one uncontradicted item of income which is included in the partnership income of Wasson and Carter which is not properly reportable on the cash receipts and disbursment method of accounting, and Petitioner contends that this item should be eliminated from the 1951 income of Wasson and Carter, in order that the Respondent's treatment of his income might be consistent. This item is an inventory of wool included in the income of the partnership of Wasson and Carter in the sum of $35,001.60. (R. 87) There were no beginning inventories in this partnership ship. The effect of treating Wasson and Carter losses for 1951 consistently would be to increase the 1951 loss of Petitioner by 75% of $35,001.60.

FACTS RELATIVE TO QUESTION 3. (Additional deduction of $15,237.32 involved)

It is undisputed that Petitioner had contributions in 1951,

the year of his loss, of $15,237.32, and non-business income of $39,013.36. (R.115 and 128 hrough 136)) The problem is as to whether or not such contributions are to be ignored in computing the amount of the loss which is available to be applied to the income of 1950.

FACTS RELATIVE TO QUESTION 4. (New trial as a result of this issue)

At the time of the trial of this case the attorney for Petitioner commenced to inquire concerning cost depletion as being available to the taxpayer in lieu of percentage depletion At such time the attorney for Respondent made the following objection:

Mr. Gibson:

Your Honor, I am going to object to any examination on cost depletion at this time because the claims for refund don't set it up. The claims are not now in evidence, but I am ready to introduce them at any time.

The Court:

Well, if they are not before me, cost depletion is not before me.

Mr. Cunningham:

Your Honor, it is our position that our claim for refund is on the basis of a net operating loss, that this is just one element in the computation of our contention that we had a net operating loss to carry back to the year 1950; that the evidence with respect to cost depletion is just one incident of the computation of the amount of the net operating loss we are entitled

to carry back, and there is no contention here the Commissioner has not been put on notice by our claim for refund, that we are claiming a net operating loss carry back. It is only one item in the computation.

Mr. Gibson:

Your Honor, it is plain the regulations say and the law requires they must set forth in detail under oath, and all of these other items that have been discussed have been set out in his claim for refund.

The Court:

There isn't anything about cost depletion in there. you have to specify that.

Mr. Cunningham:

It is our contention we don't have to specify that, that when you throw out percentage depletion that automatically the government knows that you are entitled to cost depletion.

The Court:

I sustain the objection.

Mr. Cunningham:

Well, Judge, is it on the grounds that there was no specific mention of it made in the claim for refund or on the grounds that it is a surprise to the government that we are contending for it here now?

The Court:

I sustain the objection made, it was not covered by any claim for refund.

In subsequent proceedings when Plaintiffs Exhibit 3 was offered into evidence the attorney for Respondent made the following objection:

Mr. Gibson:

Your Honor, before you go farther, as I understand this, this is an effort to establish cost of depletion, and we think Your Honor ruled on our objection to that, on the claim for refund.

The Court:

I don't understand that this is limited to the cost depletion, but it is a report he got from the government as to what had transpired between him and the government in his estate tax return, is that correct?

Mr. Cunningham:

Yes sir, that is correct.

The Court:

I am going to admit it for that purpose, but I am sustaining the objection that he cannot seek a refund on any cost depletion basis here, because he made no claim for that.

Mr. Cunningham:

Do you still own this royalty interest that was retained under the trust agreement?

Mr. Wasson (the taxpayer):

Yes.

Plaintiffs' exhibit 3 showed that the royalty interest referred to in the testimony was valued for estate tax purposes in the

estate of A. L. Wasson's deceased wife at the sum of $105,886.40. (R. 105) Mr. Wasson's testimony is to the effect that he still owns such property. Therefore there was evidence before the Court concerning the fact that Petitioner A. L. Wasson had a cost basis as to some royalty interest which he held. Further evidence on the point of cost depletion was not offered because the Trial Court makes it quite clear that he is not going to let same in.

FACTS RELATIVE TO QUESTION 5. (Additional deduction of $28,756.79 involved)

In the year 1949 the taxpayer suffered a long-term capital loss in connection with the dissolution of a corporation in which he was a stockholder, which loss is analyzed at page 204 of the Record. In the year 1950 the taxpayer had certain long term capital gains and income on which tax was due and paid. The loss which is being carried back occurred in the year 1951. The problem which arises concerning the above state of facts is whether or not you ignore the fact that the capital loss carry from 1949 has been divided in half in the year 1949.

The corrected adjusted gross income under the decision below is $39,636.03. The deduction for contributions is not an issue, nor is personal exemptions of $2400.00.

ARGUMENT

The questions involved in this Petition present substantial questions in terms of dollars and cents, contrary to the implications which might be drawn from the statement in the opinion of the Fifth Circuit. At page 3 of such opinion, the Court says: "As to the other points, while it does insist

that none of them are well taken, it argues them in more or less cavalier fashion on the theory, stated by it in its argument on point No. 5, that unless the claim of error with respect to point No. 1 is sustained, there will be no loss carry-back, and if it is sustained and the whole loss is allowed it will be sufficient to wipe out the entire 1950 tax." The taxpayer's position as to point 1 was sustained by the Fifth Circuit, but such decision in favor of the taxpayer was not sufficient to make the questions here presented moot as to this taxpayer, as indicated by the opinion of the Court. In order to fully understand this point a person needs to be versed in accounting, and in order to understand all the issues raised here a person needs to be skilled in accounting.

Concerning the Questions here raised, Petitioner would point out that same involve questions of interpretation of the Internal Revenue Code, and that the decisions of the Circuit Courts of Appeal, the Tax Court and the Court of Claims diverge on basis questions of policy. That we have here presented the basic question of what constitutes a sufficient claim for refund, and the decision of the Court below is not in accord with other decisions on the same question. That we have here presented the question of the extent of the authority of the Commissioner of Internal Revenue concerning accounting systems, and that the decisions of the Courts below are at variance with decisions of other tribunals. That all of the foregoing problems are present here will more fully appear in the discussion of each Question individually.

ARGUMENT AS TO QUESTION 1.

The answer to Question 1 raised here involves a problem

in accounting. Petitioner contends that the Conclusion of the District Court on the basis of the facts found with reference to this problem is erroneous. The Fifth Circuit misunderstood the problem as evidenced by its summary of this point, where they say: "The court erred in its conclusion No. 6 as to the unrecorded transfer from the partnership to the taxpayer of 508 head of sheep". Petitioner has not contended at any point since the trial on the merits that we were not bound by the findings of the Trial Court in this regard. We do contend however that this represents only one-half of the story, and that the Trial Court further found that such transferred sheep were included in the final inventory of A.L. Wasson personally. Based on these two findings the Trial Court says no adjustment is appropriate except to increase the sales of the partnership. Our position is that as a result of these findings it is appropriate to increase purchases of A. L. Wasson personally.

To illustrate that the above analysis is correct, let us assume that the following is the computation of gross profit of the partnership before making any adjustments:

(1) Sales		$40,000.00
Less:		
Cost of Sales		
Beginning Inventory	None	
Purchases	$50,000.00	
	$50,000.00	
Less: Final Inventory	1,000.00	49,000.00
Loss		$ 9,000.00

In order to record the transfer of the sheep, which the Court has found were transferred, the entry on the books of the partnership books should have been:

	Debit	Credit
(2) Investment of A. L. Wasson	5,924	
Sales of the partnership		5,924

The entry which should have been made on the books of Mr. A. L. Wasson personally is:

(3) Purchase of sheep	5,924	
Investment in Wasson & Carter		5,924

Let us further *assume that the individual records* of A. L. Wasson result in the following report of gross income:

(4) Sales		$60,000.00
Less: Cost of sales		
Beginning inventory	$20,000.00	
Purchases	15,000.00	
	35,000.00	
Less final inventory	15,000.00	20,000.00
Gross Profit		$40,000.00

The entry at (2) above would result in increasing the income (or more accurately, reducing the loss) of Wasson and Carter, which was the entry made by Agent Hawkins. The entry at (3) above would have also increased the expenses (or more accurately, the purchases) of Mr. Wasson.

In other words the entry at (3) above would have the effect of increasing purchases at (4) above, which would decrease the gross profit arrived at in (4) above. But no change would need be made in the final inventory figure set out at (4), because the Court has found as a fact that the sheep transferred were included in the final inventory figures of Mr. A. L. Wasson personally.

On pages 14 through 17 of the Record Agent Hawkins illustrates that he knows that the adjustment contended for by Petitioners is appropriate under the findings of the Trial Court. On page 17 he says with reference to the inventory of A. L. Wasson:

> A. I am contending, sir, that the inventory at the end of 1951 did not include this 508 head of sheep transferred November 8, 1951, the inventory which you have on the tax return.
>
> Q. But you don't know that that is true?
> A. No, sir.

On pages 36-37 of the Record Mr. Wasson explains the method of inventory for tax purposes, and on cross-examination he goes into greater detail on pages 46-47. The Thial Court makes it clear in Finding of Fact No. 14 (R. 212) and Conclusion 6 (R. 215) that he finds such sheep were included in the final inventory figures of A. L. Wasson. Agent Hawkins is quite clear on the point that if such sheep are included in the final inventory of A. L. Wasson personally then he has not made all the adjustments which are necessary. The adjustment on the partnership books for the unrecorded transfer has been made in the figures before this Court, but no adjustment has been made on A. L. Wasson's individual tax return.

ARGUMENT AS TO QUESTION 2.

Orginally in this case the taxpayer contended that he and Wasson and Carter were on the accrual basis of accounting. This contention was decided adversely by the Trial Court, but now Petitioner contends that in view of the findings of fact he is entitled to make certain adjustments to conform his accounting to the cash basis.

Mr. Hawkins testifies at page 63 of the Record, as follows:

"Oftentimes we run into this thing, what we call the—I guess what we could call the hybrid method, which is cash for receipts and for disbursements, but the inventories are used to arrive at cost of sales. It is not one, I think, that the Commissioner objects to as long as it clearly reflects income . . .

Petitioner contends that the foregoing is not an accurate statement of the law on the subject, as developed by the Courts; in fact Appellant contends that prior to the revision of the Code in 1954 that there was no such thing as a hybrid system of accounting for tax purposes; a taxpayer either had to be on one system or the other.

At paragraph 2820.03 Commerce Clearing House has this to say in its 1956 Standard Federal Tax Reporter: "A hybrid method of accounting may be authorized in the regulations for taxable years beginning after 1953. This is a new provision in the 1954 Code (Section 446 (c) (4) and is contrary to prior law, under which a hybrid system of accounting was not permissable.

The Committee report concerning the new section of the law had this to say: "All methods of accounting recognized under existing law are continued. In addition one or more hybrid methods may be authorized in the regulations issued . . . "To labor this point further seems inappropriate, but if further authority is desired see Elsie Sorelle 22TC 459. Decision No. 60, where the Court says: ". . . and the Commissioner in the exercise of his discretion under section 41. may not (as his contentions in this case indicate he is apparently attempting) compel the taxpayer to remain on such a hybrid basis."

Another case which is illustrative of the point Appellant would make here is DIAMOND A CATTLE COMPANY, 21 TC 1

In such case the taxpayer had deducted interest in the years 1940, 1941 and 1942 as same was paid, and had used inventories in the computation of income. In other words the taxpayer was using what has been described as a hybrid method of accounting. The Tax Court found as a fact that this interest had accrued in prior years and hence was not deductible in the years claimed by the taxpayer. In the DIAMOND A case the Commissioner was contending that a hybrid system was not sanctioned by law, and the Tax Court upheld him. Petitioner asks that he not be saddled with a hybrid method of accounting. Here the Commissioner sought to make certain adjustments to put taxpayer on a cash basis and was upheld. Petitioner only asks that further adjustments be made which are apparent in order to put the partnership on a cash basis.

Another case is V. T. H. BIEN, 20 TC 49. In this case the Tax Court found that the bookkeeping system of the taxpayer was a hybrid method, and upheld the Commissioner's determination that the accounting system most clearly resembled a cash receipts and disbursements method.

Therefore since the Commissioner has urged that Wasson and Carter is on the cash basis. Petitioner would urge that we are entitled to the adjustments which are apparent in order to put such partnership on the cash basis. Petitioner urges that the wool inventory should not be included in the income of such partnership in the year 1951; and in support of this would call the Court's attention to the following: At page 13 of the Record Mr. Hawkins testifies as follows:

Q. How would a cash basis taxpayer report that, Mr. Hawkins?

A. A cash basis taxpayer would hold his cost to apply against his selling price.

Q. He would only report it when that wool was actually sold?

A. That is right.

The regulations on the matter are as follows: Reg. 111, Sec. 29.22(a)-7. Gross income of farmers.—A farmer reporting on the basis of receipts and disbursements (in which no inventory to determine profits is used) shall include in his gross income for the taxable year (1) the amount of cash or the value of merchandise or other property received during the taxable year from the sale of livestock and produce which were raised during the taxable year or prior years, (2) the profits from the sale of any livestock or other items which were purchased and (3) gross income from all other sources.

The regulation with reference to expenses in farming and ranching operations, is as follows: Reg. 111, Sec. 29.23(a)-11. Expenses of farmers.— . . . The cost of feeding and raising livestock may be treated as an expense deduction . . . Where a farmer is engaged in producing crops which take more than a year from the time of planting to the process of gathering and disposal; expenses deducted may, with the consent of the Commissioner be determined upon the crop basis, and such deductions must be taken in the year in which the gross income from the crop has been realized.

In other words it is Petitioner's view that Mr. Hawkins and the regulations are agreed that the wool inventory in question would be properly reported in the year of sale as income to a cash basis taxpayer; hence for the year in question we would need to eliminate the wool which was inventoried at the end of the year 1951 from the computation of the income for that year, and only report the income from same at the time such was sold. Therefore Petitioner contends that the income of

the partnership should be reduced by $35,000.00 and A. L. Wasson's loss in Wasson and Carter be increased by 75% thereof.

It is always true of the cash method of accounting, that you deduct expenses in the year incurred irrespective of whether or not the income with respect to such expenses has materialized. It is also true that you do not report items raised or produced until the cash has been realized in connection with a disposition thereof. Exceptions to these rules are only present where a taxpayer is on the accrual basis or where a crop takes longer than one year to produce.

ARGUMENT AS TO QUESTION 3.

Here the decision of the Court below is directly in conflict with a decision of the Tenth Circuit, hereinafter cited. Since the decision of the Tenth Circuit, Congress has repeatly re-enacted without signifigant change the applicable provisions of the Code which were in issue before the Tenth Circuit.

The problem here is one of statutory construction. We are concerned with determining the "net operating loss" of 1951. The statute in Section 122 (a) gives us the following definition:

> "As used in this section, the term 'net operating loss' means the excess of the deductions allowed by this chapter over the gross income, with the exceptions and limitations provided in subsection (d).

Petitioner urges that contributions are a deduction allowed by "this chapter". The applicable Section of the Code is Section 23 (o). None of the exceptions and limitations provided in subsection (d) relate to any adjustment for contributions. However, the problem arises because Section 23 (o) places a

percentage limitation on the amount of the deduction allowable for contributions. This limitation is a percentage of adjusted gross income.

Because of this percentage limitation it can be argued that since there is no adjusted gross income for the year 1951 there can be no deductions for contributions. Petitioner's answer to this is that the percentage limitation is for the purpose of determining the income tax liability of the year involved, and by definition does not apply when you are concerned with the amount of "net operating loss".

Petitioner would urge this to be true for the reason that a different construction would ignore the provisions of Section 122(d)(5). This section provides:

> "Deduction otherwise allowed by law not attributable to the operation of a trade or business regularly carried on by the taxpayer shall . . . be allowed only to the extent of the amount of the gross income not derived from such trade or business."

Contributions is such a deduction as is described in this Section, and if the percentage limitation of 23(o) denies the deduction for purposes of computing "net operating loss" then Section 122(d)(5), above, is wasted words as same applies to our situation.

Petitioner would point out that the result contended for here was the construction placed on a prior revenue statute. In GERALD HUGHES, 15 BTA 215 the exact point was involved except that the Board was construing the 1921 Act, while our case involves the 1939 Code and amendments. However the principles are the same. The question before the Board was whether or not contributions were a proper deduction in computing net loss available to be carried to another year. The

Board decided against the taxpayer, as follows: (pg. 219)

> Since Section 214 (a) (11) of the Revenue Act of 1921 limits the deductions for contributions to 15 percent of the taxpayers total net income, and the contributions are for 1921, when there was no net income, it is obvious that the amount of such contributions can not further increase the net loss to be carried forward against income of 1922."

However this decision of the Board was reversed by the Tenth Circuit in HUGHES V. COMMISSIONER, 38 F (2nd) 755. In this case the Circuit Court approves the computations of the taxpayer, which involved a deduction for Contributions so as to increase a net loss, as shown on page 216 of the Board's decision.

ARGUMENT AS TO QUESTION 4.

The Trial Court ruled out evidence concerning cost depletion, although the element of a cost basis in royalty has been demonstrated to be in the record, on the grounds that same was not mentioned in the claim for refund. The claim for refund was on the basis of a net operating loss carry-back. (R. 113) The decision of the Courts below are in conflict with the decisions of other courts, hereinafter cited.

Petitioner would contend that the claim for refund was sufficient to support the claim for cost depletion, and particularly is this true in view of the fact the Commissioner for the first time at the trial raised the objection that the claim for refund was defective in this respect.

What is a sufficient claim for refund? Reg. 111, Sec. 29.322-3 says that "the claim must set forth in detail each ground

upon which a refund is claimed, and facts sufficient to appraise the Commissioner of the exact basis thereof." Commerce Clearing House editors have this to say in all their Standard Federal Tax Reports concerning these requirments: "A claim on form 843 should clearly set forth in detail each ground upon which the claim is based. This does not mean that the taxpayer's supporting evidence must be included, but only that material or ultimate facts must be stated." (This same wording is included in the regulations issued under the 1954 Code, and Commerce Clearing House makes this same comment with reference to the new requirments, but the quotations above are based on the law prior to 1954). In other words Appellant contends that the refund claim was sufficient when it set out that taxpayer was claiming a refund on the grounds that he had sustained a loss in 1951, which he was enitiled to carry-back to 1950—this being the "grounds" for the claim. One of the fact issues with reference to such "ground" is whether or not taxpayer is entitled to any cost depletion, and the amount thereof, since he cannot claim percentage depletion in connection with such computations.

In support of this analysis see **Jones vs Lucas** 33 F (2nd 907. The court has this to say, concerning our proposition:

"I conclude that the taxpayer who brings suit after refund has been denied may rely for recovery only on the ground presented to the Commissioner, but that in support of the grounds relied upon he is not confined to the evidence adduced before the Commissioner, but he may offer entirely new and additional evidence."

In other words our problem is whether the net operating loss carry-back is the ultimate fact which must be set out in the claim for refund, or whether the fact that taxpayer is

claiming some cost depletion as a part of such carry-back is the ultimate fact which must be stated in the claim for refund. Petitioner contends that it is the former, since the policy of the law in this respect is that the Commissioner be put on notice of the claims of the taxpayer such that same may be settled in administrative channels if possible. Since the Code provides that you must make certain adjusments in connection with an operating loss carry-back, when there is percentage depletion, then as a matter of course the Commissioner knows that you are entitled to cost depletion in lieu of such percentage depletion. Therefore Petitioner contends it is not necessary that the taxpayer inform the Commissioner that he is claiming cost depletion in lieu of percentage depletion and the amount thereof.

Further Petitioner contends, since taxpayer's claim with respect to an allowance for cost depletion was brought to the attention of Mr. Hawkins, that to throw out our taxpayer's deduction on the technical grounds that the underlying claim is not comprehensive enough is erroneous. (R. 30)

A case which holds in line with the above contention is Ohio Oil Co. vs U. S. A., (Dist. Ct.) 15 AFTR 1114, 36-2USTC No. 9415. The Court has the following to say:

"The language used must be considered in the setting in which it was used. The record leaves no doubt in my mind that the agents of the Bureau knew precisely what the claim of the taxpayer was. The position of the taxpayer, known to the Bureau, was that it desired to have a fair allowance for depletion regardless of method, and the Bureau was not embarrassed in any way by failure of the taxpayer to be specific as to the method desired."

A case directly in point is NATIONAL FORGE & ORDNANCE

COMPANY v U S, US Court of Claims, No. 132-56 7/12/57, 57-2 USTC No. 9839. In this case the Court of Claims holds a refund claim to be adequate where such claim for refund only stated that a refund was due because of failure to allow the proper net operating loss deduction. Such was set out in Petitioner's claims for refund and same should be sufficient for Petitioner to introduce evidence concerning cost depletion.

Can it be successfully contended that Petitioner's offer of proof in this regard was insufficient? Petitioner would urge to the contrary. Professor McCormick's latest work on Evidence at page 113 says concerning offers of proof:

> "... a sufficient offer of proof may be made without producing the witness, if it is sufficiently specific, and if there is nothing on the record to indicate a want of good faith or inability to produce the proof."

Petitioners argue that the record is quite clear that all parties to the trial were quite well aware of the significance of the ruling of the Trial Court on this issue at pages 30 through 35 and 37-38 of the Record. The Trial Court knew what Petitioners were offering to prove and so did Government's Counsel.

It is also the opinion of Petitioners that no exception to the ruling of the Trial Judge was necessary under Rule 46 of he Federal Rules of Civil Procedure.

ARGUMENT AS TO QUESTION 5.

The problem involved here is one of statutory construction. The provisions of the Code in question are as follows:

> Section 122 (d)(4)-Gains and loses from sale or exchange of capital assets shall be taken into account without regard to the provisions of Section 117(b).

Section 117(b)-In the case of a taxpayer, other than a corporation, only the following percentages of the gain or loss recognized upon the sale or exchange of a capital asset shall be taken into account in computing net capital gain, net capital loss, and net income:

. . .50 per centum if the capital asset has been held for more than 6 months.

Section 117 (e)-Captial loss Carry-over
(1) Method of Computation -- If for any taxable year beginning after December 31, 1941, the taxpayer has a net capital loss, the amount thereof shall be a short-term capital loss in each of the five succeeding taxable years . . .

The total amount of capital gain realized by the taxpayer in 1950 was $96,016.86; the Courts below approved a computation which would include one-half of this figure as the amount to be added to the income of 1950 under the terms of Section 122(d)(4). But taxpayer would raise this question: What about the capital loss carry-over from 1949? Isn't Section 117(b) the Section which originally divided such loss carry-over in half? In other words when examining the items in the 1950 tax return which have been affected by Section 117(b) do we notice that such Section has divided the gains in half and ignore the fact that such Section has also divided the 1949 loss in half?

The loss carry-over from 1949 is properly referred to as a Section 117(e) item. Then we can re-phrase our question to be: Are Section 117(e) items within the meaning of "capital gains and losses" as that term is used in Section 122(d)(4)? Keeping in mind that were it not for Section 122(d)(4) no adjustment concerning capital gains and losses would be appropriate in connection with computing a net operating loss

carry-back, Petitioner wishes to call the Court's attention to a case which is directly in point. The case is GODFREY M. WEINSTEIN 29 TC—, No. 19, CCH Dec No. 22,638. In this case the Tax Court points out that the Commissioner concedes on brief that Section 117 (e) items are within the meaning of "capital gains and losses" as that term is used in Section 122 (d) (4).

The Weinstein case does not stand for any other line of reasoning. It does not stand for the proposition that such case is acknowledging the fact that a taxpayer gets some deduction in computing a net operating loss deduction for a capital loss carry-over. The contention could not seriously be made that a taxpayer gets no deduction for a capital loss carry-over in connection with a net operating loss carry-back. Such deduction is certainly within the provisions of Section 122 (a), which says that the term net operating loss is to include the deductions allowed by this "chapter". If the controversy in the Weinstein case in the Tax Court related to whether or not the taxpayer was entitled to any deduction concerning a capital loss carry-over, the Court would have phrased the controversy in terms of whether or not a Section 117 (e) item was within the meaning of "deductions" as that term is used in Section 122 (a).

In view of the foregoing Petitioners would request the same treatment as that afforded the taxpayer in the Weinstein case In the alternative Petitioners request that the Court tell us the Commissioner was wrong in the other proceedings, and that the Tax Court was wrong in impliedly approving such admission on the part of the Commissioner.

To approach the problem from a different point of view, let us try to ascertain the Congressional intent in the matter.

The purpose of Congress in making certain adjustments concerning net operating loss deductions has always been to make such adjustments as would restore the taxpayer's income or loss to approximate economic gain or loss. In this connection attention is directed to the Report of the Ways and Means Committee 76th Cong., 1st Sess., H. Rept. 85 pg 17-18) Seidman's Legislative History of Federal Income Taxes, Vol 1, pg. 1919, where it is pointed out:

> "The exceptions and limitations provided in Section 122(d) are for the purpose of insuring that only an economic loss will be taken into account."

In our situation taxpayers economic gain is the full amount of his 1950 gains ($96,016.86) less the full amount of the 1949 loss($57,513.58), and taxpayer has already included one-half of such gains in income ($19,251.64), leaving $19,251.64 to be included in income to arrive at the economic gain which is unreported. It was not the intent of Congress to make all economic adjustments against the taxpayer; as witness, the following:

> "Under the present law an individual in computing his gain from sales or exchange of long term capital assets takes into account only the percentages specified in Section 117(b). . . . of the gain. In computing his deduction for long term capital losses THE AMOUNT OF THE LOSS is reduced by the same percentage. As a result, his actual gain will often be greater than the amount included on account of the long-term capital gains and his actual loss may be greater than the amount deductible. The effect of this amendment is to make him compute, for the purposes of net operating loss deduction, his long-term capital gains and his long-term capital losses without regard

to such percentages. The object of the amendment is to reach a truer figure representing the individual's ECONOMIC INCOME . . "

This statement is taken from the Congressional Record, Vol. 84, pg. 7496-97, and is an explanation made by Mr. Cooper. (Seidman's Legislative History of Federal Income Taxes, Vol. 1, pg. 1920) Does it make any difference that the loss involved comes from 1949?

In view of all the foregoing, Petitioner earnestly requests that this Petition be granted.

Respectfully submitted,

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OPINION OF FIFTH CIRCUIT

Before HUTCHESON, Chief Judge, and RIVES and WISDOM, Circuit Judges.

HUTCHESON, Chief Judge: Based upon a claimed net operating loss carry-back from the calendar year 1951, the suit was for the recovery of income taxes over-paid for the calendar year 1950. Tried to the court without a jury, there were findings of fact and conclusions of law, not reported, rejecting plaintiffs' claim on the general ground, as to each of its elements, that taxpayers failed to sustain their burden of proving the claimed 1951 net operating loss carry-back deduction against 1950 income, within the meaning of Sec. 23 and 122(d) of the Internal Revenue Code of 1939.

Appealing from the judgment, plaintiffs are here attacking the findings and conclusions that were adverse to them, and under seven numbered points,[1] urging with vigor and convict-

---

[1] Point 1. The court erred in treating the losses shown on the records of A. L. Wasson as community losses of himself and his second wife for the reasons that (a) such losses were traced to the partnership of which A. L. Wasson was a member and, under the undisputed evidence and Texas law, were not community losses but the separate losses of A. L. Wasson; and (b) in the alternative, the loss of one of the partnerships was the separate loss of A. L. Wasson by virtue of the prenuptial agreement between taxpayers.

Point 2. The court erred in its conclusion No. 6 as to the unrecorder transfer from the partnership to the taxpayer of 508 head of sheep.

Point 3. Th court erred in not making adjustment for the wool inventory included in the income of Wasson and Carter, so as to put Wasson's 1950 income on a cash basis.

Point 4. The court erred in holding that contributions were not properly a part of the loss carryback.

Point 5. The court erred in not permitting appellant to offer evidence on cost depletion.

Point 6. The court erred in approving the computation of the adjustment for captial gains in connection with the net operating loss.

Point 7. The court erred in its conclusion No. 10, in holding that the conceded $50,000 worthless mineral deduction fell clearly within the term "trade or business" in Sec. 22 (n)(1) I.R.C. 1939, and for that reason denying taxpayers' attempt to increase their contributions.

ion that the court erred in so finding and holding.

As the taxpayers see the case, while they devote more time to and argue more earnestly point No. 1, because of its greater effect on the general result, they argue each of the other claims of error with conviction, insisting as to each that it is well taken and requires a reversal.

Appellee sees the case differently. It recognizes the great significance of the holding attacked in point No. 1, and its effect upon the case, and argues this point with vigor and earnestness. As to the other points, while it does insist that none of them are well taken, it argues them in more or less cavalier fashion on the theory, stated by it in its argument on point No. 5, that, unless the claim of error with respect to point No. 1 is sustained, there will be no loss carry-back, and if it is sustained and the whole loss is allowed, it will be sufficient to wipe out the entire 1950 tax.

As to point No. 5 for instance, relating to cost depletion, appellee, after categorically stating that it is of no consequence on this appeal because no claim was made for it in the claims for refund, no offer of proof was made at the trial, and no exception taken to the judge's ruling, and accordingly it is not a proper issue here on appeal, goes on to say: "In all events the issue is academic since the claimed 1951 operating loss carry-back deduction depends essentially on taxpayers' erroneous contention, points 1(a) and (b), made with respect to the district court's disallowance of Mrs. Wasson's moiety of the 1951 community loss, viz., $53,678.02 for purposes of this appeal, and the 1951 operating loss carry-back deduction would still be zero if the percentage depletion adjustments under Sec. 122 of the 1939 Code were left out of account altogether."

Certainly it is the case that the issue of the character of the property loss and, therefore, the nature of the loss whether community or separate, is the dominant point in this case We turn, therefore, to its consideration, noting with respect to it that the court, after finding that Wasson was a widower from August 27, 1950 until September 3, 1951, when he married his present wife, that she had no income between Sept. 3, 1951 and December 31, 1951, from her separate property, further found:

> "10. A. L. Wasson's books for 1951 show losses (largely sheep and cattle losses) which he contends were his separate losses and should be used in computing his net operating loss corry-back from 1951 to 1950. The Commissioner of Internal Revenue disallowed one-half of the losses incurred between Sept. 3, 1951, and Dec. 31, 1951, determining that this portion of the loss was a community loss attributable to Mrs. Mattie Pallmeyer Wasson and not allowable to A. L. Wasson for carry-back purposes against his income and that of his former spouse, Mrs. Mattie Wasson, for the taxable year 1950."
>
> "11 Considering all the testimony and exhibits, the losses (referred to in par. 10, supra) occurred between Sept. 3, 1951 and Dec. 31, 1951. The evidence does not indicate that the losses occurred earlier in the taxable year, prior to this second marriage."

and, on the basis of these finding, concluded:

> "3 That the Commissioner's allocation of $48,550.98 of the 1951 loss to Mattie Pallmeyer Wasson

> as a part of the community operation was correct. The losses in this case were largely sheep and cattle losses. Clearly, any increase of the livestock would have been community gain. It has not been shown that there was no increase of the livestock between the time of the taxpayer's second marriage and the end of the year. Any loss attributable to the decrease of the livestock was community loss. The taxpayer has the burden of showing that the loss was separate. Allen v. Commissioner, 22 T.C. 70. This burden was not met.

It is the appellant's position that these findings and conclusions are patently and inherently wrong; that, in making them, the court has incorrecly disregarded the compulsive nature and effect of the evidence, including particularly the time factor in the second marriage, and of the controlling principles of law; that, under the undisputed facts of record and the law of the Texas cases, these findings and conclusions may not stand.

Appellee, on its part, pointing to the findings and conclusions urges upon us that the district court correctly held that Mr. Wasson failed to sustain his burden of proving that the 1951 sheep and cattle losses were not, as agent Hawkins testified by way of conclusion they were, losses of property belonging to the community of the second marriage with one-half of them, therefore, belonging and attributable to the second wife and hence not available to him for carry-back purposes, but, on the contrary, were losses of his separate property and wholly available to him.

Insisting that the burden of proving a separately available 1951 loss carry-back deduction **made it incumbent**

upon Wasson to show that the 1951 operating losses occurred prior to his second marriage, and pointing to the finding of the district court that the heavy 1951 losses all occurred between September 3, and December 31, 1951, appellee, quite incorrectly we think, insists that it is thereby established that Wasson failed to sustain his burden of showing that the 1951 loss claimed was of separate instead of community property.

It recognizes, however, the bizarre indeed the almost fanciful nature of the agent's conclusional testimony on which the district judge based his findings and conclusions. (1) that of the heavy sheep and cattle losses sustained in 1951, none of them occurred prior to August 30, 1951, but all were suffered in the last four months of the year; (2) that none of the sheep and cattle lost were the original stock constituting the separate property of the taxpayer but all were increase thereof born after August 30th and before December 31st. Hard put to it, therefore to point to any evidence or any theory of law upon which it can hope to justify the decision below, that the taxpayers as a community sustained losses consisting wholly of the offspring of Wasson's separate property, born and dying in the last four months of the year, except the greatly overworked one that the burden was upon the taxpayers to make out their case and they failed to sustain the burden, returns in its brief again and again to the theme thus stated by it on page 25:

> "We emphasize the burden incumbent on the taxpayer with respect to the carry-back deduction herein claimed because of the unusual mode of proof taken by the taxpayer in this proceeding. The principal witness called by both the taxpayer and by the

> government was Ben Hawkins, the Revenue Agent. * * He explained his adjustment and the reasons therefor. All of the computations here involved * * * are based on his unrefuted testimony. No convincing contradictory evidence with respect to these adjustments was introduced although Wasson's testimony was, in one respect at least, directed to that end. Wasson testified that sheep losses on the * * New Mexico ranch occurred in the spring of 1951 immediately prior to the transfer of 508 head, down to his Red House ranch in Big Spring, Texas, in July of that year."

After stating that this self serving testimony is directly refuted by Agent Hawkins' testimony on direct, as taxpayer's witness, the appellee concludes:

> "With respect to this testimony, the District Court concluded that **while 'there is some question in the record as to just when these losses occurred, whether before or after the taxpayer's second marriage', he had 'failed to meet his burden of proof', and the trial judge found that, under all the evidence,' the losses * * * occurred between Sept. 3, 1951 and Dec. 31, 1951.'** "
> (Emphasis supplied.)

Pinpointing the wholly inconclusive and conclusional nature of the testimony of Agent Hawkins, on which the findings and conclusions of the argument of the appellants are based, by setting it out in question and answer form,[1] the tax-

[1] Q: "All right, now, this adjustment for one-half of the community loss, would you please explain to the court how you arrived at that figure of $48,550, whatever it is? Let's get the exact amout, $48,550.98."

payers meet appellee's arguments and assumptions head on. They meet them in fact by pointing to Wasson's uncontradicted and entirely reasonable testimony[3] and contrasting it with the wholly unsupported, indeed unwarranted conclusion of the agent that all of the losses occurred after August 30th, completely contradicted as it was by his statement that he arrived at his conclusion by the book method that

---

A: "For the year 1951 I took the trial balances—the trial balance that they used in preparing Mr. A. L. Wasson's 1951 return, located the ledger sheets for each amount on it, took off a trial balance at Aug. 31, 1951, and determined loss or profit for the period Jan.1, through Aug. 31, 1951, and a loss or profit from Sept. 1, 1951, through Dec. 31 1951, with **the exception of items that I considered to be separate income to Mr. A. L. Wasson, royalty, oil royalty, and sales or exchanges of capital assets.**"

Q. "What about partnership losses, were they, did you do the same thing for the partnerships?"

A: "Yes."

Q. "That were involved?"

A: "**Yes, for each partnership I took a trial balance at Aug. 31st and allocated the profit or loss based on the trial balances between the period Jan. 1st to Aug. 31st to Dec. 30th.**"

Q: "**Did you make any allocation for items which would accrue throughout the entire year that would only be charged off of the books as of the end of the year?**"

A: "No sir."

Q: "**How did you arrive at the inventory as of Aug. 31st?**"

A: "**By the only method available to me, the book method, the number on hand plus the number purchased less the number sold.**"

Q: "**Would that have reflected any death loss?**"

A: "**No, sir.**"

Q: "**It Would not?**"

A: "**No, sir.**"

Q: "**That if there had been a considerable death loss or one thing and another concerning these sheep then that would not show up as a result of your allocation that you have made?**"

A: "**That is right, sir.**" (emphasis supplied)

3. In answer to the question when the major portion of the losses occurred in 1951, Wasson answered that they bought the sheep and cattle right after the first of the year, that they put the sheep on the ranch and they begin to lamb out early, that there came no more rain, that they had lambed out 3200 lambs, that there was no grass and they had to move, and that they lost all of the lambs, and a good many of the ewes died.

Asked, "Did this death loss occur prior to the fall?", he answered: "Oh, yes, it did that spring along in May and June."

the method used by him would not have reflected any death loss , and that in answer to the question **"That if there had been considerable death loss or one thing or another concerning these sheep then that would not show up as a result of your allocation that you have made?", he answered, "That is right, Sir."** (Emphasis supplied.)

They meet them in law by calling attention to the statement in the court's conclusion No. 3, **"The losses in this case were largely sheep and cattle losses. Clearly any increase of the livestock would have been community gain. It has not been shown that there was no increase of the livestock between the time of the taxpayer's second marriage and the end of the year."** (Emphasis supplied), and his conclusion in effect that because of the failure of the taxpayer to show that there was no increase of the livestock between the time of the taxpayer's second marriage and the end of the year, the taxpayer did not meet his burden.

Saying only that there was no warrant for the action of the court in rejecting the testimony of Wasson that his losses occurred in the spring and concluding that none of these heavy losses occurred in the first eight months of the year but all of them were in the last four months of it, we put to one side for the present the court's rejection of taxpayer's uncontradicted, unimpeached, and wholly reasonable testimony that heavy losses were sustained in the spring of 1951, the natural lambing time.

We do this because the implied, if not stated, conclusion of the court that none of the losses for which claim was made, whether occurring before or after August, 1951, were of Wasson's separate property but all were of the increase thereof and were born and died within the four months from August

30 to Dec. 31st, is, on its face, unreasonable, indeed impossible, only because it is not supported but is contradicted by all the credible testimony, but because it is completely contrary to facts of animal husbandry, of which the court takes judicial knowledge.

We do this, too, because the substance and effect of the findings and conclusions of the district court, that the livestock losses of more than $100,000 occurred in he short space of four months after the beginning of the second community and are all presumed to be community in the absence of specific proof showing the contrary, is contrary to, indeed in the teeth of the Texas Separate and Community Property system and laws as established in and by the Texas Constitution and statutes, declaring what is **separate** and what is **community property** in Texas, and all the Texas decisions[1] thereon, beginning with Schmidt v. Huppman, 73 Tex.112, and continuing down to date.

It is quite plain from the district judge's conclusions that he recognized that the Texas community system deals with property and substantial property rights, since he finds not that mere theoretical accounting could convert separate into community property but that the increase if any of the Wasson's separate livestock would have been community, and if there was loss of such increase this would be a community loss. His error proceeds from the non sequitur contained in the same paragraph 3, that "**any loss attributable to the decrease of the livestock was community loss.**" (Emphasis supplied.) In so stating, the district judge went directly counter

[1] Farrow v. Farrow, 238 SW(2) 255; Barrington v. Barrington, 290 SW(2) 297; Bumer v. Kallison, 297 SW(2) 898; Irma Jones v. Hunt, 47 B.T.A. 29; and Schmidt v. Huppman, 73 Tex. 112.

to the preceeding statement which was **that any increase of the livestock would have been community gain and any loss of such increase would have been community loss.** (Emphasis supplied.)

In the same way, while the district judge correctly stated that the theoretical burden of showing that the loss was separate was on the taxpayer, when he declared "This burden was not met", he simply overlooked the fact that, while in any situation really involving conflicting claims of separate and community property where there has been a commingling the presumption is in favor of the community, this presumption is a reasonable one and cannot arise in this case under the undisputed evidence, including the brief time factor establishing that within the meaning of the decisions, no commingling has, or could have, occurred.

No case in the books has been cited to us, we have found none, in which under circumstances of this kind, it has been held that a spouse who brought into the marriage large amounts of separate property, as here livestock, is put upon specific proof that that separate property had not, within the short period of four months, such as here, been commingled with and converted into community property.

We think that the district judge's conclusion in the case, that because of the agent's conclusional testimony that no losses occurred prior to August 30th, the burden of proof was on the taxpayer to show, and he had not shown, that there had been no commingling of his separate with community property, and that, therefore, one-half of the admitted livestock losses must be held to be of community property, is running a good principle into the ground. If the shoe were on the other foot and it was Mrs. Wasson who was claiming

the loss carry-back against her income of 1950, the United States and the district judge would rightly make short shrift of her claim that one-half the losses were available for her use. the fact that she cannot make and does not attempt to make use of them cannot change or affect the inescapable conclusion that the losses were of Mr. Wasson's separate property and, therefore, his losses.

Because of these views, we find it unnecessary to deal with appellant's contention under 1(b) that the pre-nuptial agreement between Wasson and his second wife required the holding that the losses were of the separate property of A. L. Wasson and not of the community.

While, as we have endeavored to show above, we find ourselves in complete agreement with appellants on their point No. 1, the matter stands differently with respect to their other points two to seven. Here we find ourselves in agreement with the action of the district judge, and with the arguments of the appellee in their support, and, without undertaking to deal seperately with them, we content ourselves with saying that, to the extent that the judgment is affected by the matters complained of in them it is AFFIRMED, and to the extent that it is affected by the findings and conclusions that the admitted losses were of community property and attributable one-half to Wasson and one-half to his wife, it is REVERSED with directions to enter judgment accordingly.

FINDINGS OF FACT AND CONCLUSIONS OF LAW OF THE DISTRICT COURT THAT ARE STILL APPROPRIATE HERE

(Title Omitted)

The above-entitled action having been tried to the Court, without a jury, the Court being fully informed in the premises, and having, on March 7, 1956, handed down its memorandum opinion in the matter, make the following findings of fact and conclusions of law:

FINDINGS OF FACT

1. This action was instituted by taxpayers against the United States to recover certain income taxes and penalties alleged to have been paid to the defendant for the taxable year 1950.

2. The Court has jurisdiction, 28 U. S. C. (1952 Ed.) 1340; venue is properly laid in the Abilene Division of this District, 28 U. S. C. (1952 Ed.) 1402 (a); and all the required conditions precedent to institution of this action have been fulfilled, Internal Revenue Code (1954), Section 7422 (a).

9. Taxpayer's books and records, including those of Wasson and Carter, did not reflect a definite method nor did they clearly reflect income. Based on evidence submitted by both parties, taxpayers were on a cash receipt and disbursements basis.

14. There was an unrecorded transfer from the partnership of Wasson and Carter to A. L. Wasson of 508 head of sheep

in 1951. This resulted in an understatement of sales of the partnership in the sum of $5,924 but had no effect on the personal return of Wasson since these sheep would have been included in his closing inventory, thereby reducing the number of sheep sold or lost.

18. For the taxable year 1949, A. L. Wasson and his wife had a net capital loss in the amount of $29,756.79, which when reduced by the $1,000 capital loss allowable for the year 1949, left a capital loss to be carried forward to the year 1950 in the amount of $28,756.79. For the taxable year 1950 taxpayer had a capital gain of $48,008.43. Combined with the capital loss carry-forward, this produced a net capital gain for the year 1950 in the amount of $19,251.64. There was no capital loss carry-over to 1951 as the entire amount was absorbed by the 1950 capital gain.

CONCLUSIONS OF LAW

1. That the taxpayer failed to carry the burden incumbent on them to substantiate the deductions sought, other than in respect to the estate tax fair market vaule of the abandoned W. F. Norton Well No. 1.

2. That the Commissioner has wide discretion in determining the method of accounting, where the books do not reflect a definite method or clearly reflects income. The use of inventories by the taxpayer is not conclusive on this question. The Commissioner's finding that the taxpayer was on a cash receipt and disbursements basis is upheld. The accrued expenses were properly disallowed.

6. On the issue of understatement of sheep sales of the partnership of Wasson and Carter, it has been found as a fact that there was an unrecorded transfer from the partnership to the taxpayer of 508 head of sheep. This resulted in an understatment of sales of the partnership with no effect on the personal return of Wasson since these sheep would have been included in his closing inventory, thereby reducing the number of sheep sold or lost.

9. Section 122 (d) (4) of the Internal Revenue Code of 1939 does not apply to affect the capital loss carry-over from 1949.

JOE E. ESTES

United States District Judge

APPENDIX

ACT OF 1921 (42 Stat. L. 227, C. 136)

Sec. 204 (a) That as used in this section the term "net loss" means only net losses resulting from the operation of any trade or business regularly carried on by the taxpayer . . .; and when so resulting means the excess of the deductions allowed by Section 214 or 234, as the case may be, over the sum of the following:

(1) the gross income of the taxpayer for the taxable year . .

Sec. 214 (a) That in computing net income there shall be allowed as deductions:

(11) Contributions or gifts made within the taxable year to or for the use of: (A) The United States . . : (B) any corporation or community chest . . . (C) . . .; to an amount which in all of the above cases combined does not exceed 15 per centum of the taxpayer's net income as computed without the benefit of this paragraph. . . .

INTERNAL REVENUE CODE OF 1939:

Sec. 23. Deductions from Gross Income.

In computing net income there shall be allowed as deductions:

(o) Charitable and Other Contributions -- In the case of an individual, contributions or gifts payment of which is made within the taxable year to or for the use of:

(1) The United Staes, . . .

(2) A corporation, trust, or community chest . . .

. . . .

to an amount which in all the above cases combined

does not exceed 15 per centum of the taxpayer's adjusted gross income . . . .

. . . . . .

(s) (As added by Sec. 211 (a), Revenue Act of 1939; C. 247, 53 Stat. 862) Net operating loss deduction -- For any taxable year beginning after December 31, 1949, the net operating loss deduction computed under Section 122.
(26 U. S. C. 1952 Ed., Sec. 23)

Section 41. General Rule.

The net income shall be computed upon the basis of the taxpayers annual accounting period. . . in accordance with the method of accounting regularly employed in keeping the books of such taxpayer; but if no such method of accounting has been so employed, or if the method employed does not clearly reflect the income, the computation shall be made in accordance with such method as in the opinion of the Commissioner does clearly reflect the income.
(26 U. S. C. 1952 Ed., Sec. 41)

Section 117. Capital Gains and Losses.

(b) (As amended by Sec. 150 (c), Revenue Act of 1942, c. 619, 56 Stat. 798) Percentage taken into account -- In the case of a taxpayer, other than a corporation, only the following percentages of the gain or loss recognized upon the sale or exchange of a capital asset shall be taken into account in computing net capital gain, net capital loss, and net income:

. . . .

50 per centum if the capital asset has been held for more.

than 6 months.

(e) Capital loss carry- over--

(1) Method of computation -- If for any taxable year beginning after December 31, 1951, the taxpayer has a net capital loss, the amount thereof shall be a short-term capital loss in each of the five succeeding taxable years to the extent that such amount exceeds the total of any net capital gains of any taxable years intervening between the taxable year in which the net capital loss arose and such succeeding taxable year. For purposes of this paragraph a net capital gain shall be computed without regard to such net capital loss or to any net capital losses arising in any such intervening taxable years.
(26 U. S. C. 1952 ed., Sec. 117)

Section 122 (As added by Sec. 211 (b), Revenue Act of 1939, supra, and as amended by Secs. 105 (e) and 150 (e), Revenue Act of 1942, supra). Net operating loss Deduction.-
(a) Definition of Net Operating Loss. -- As used in this section, the term "net operating loss" means the excess of the deductions allowed by this chapter over the gross income, with the exceptions, additions, and limitations provided in subsection (d).

. . . . .

(d) Exceptions, additions, and limitations. -- The exceptions, additions, and limitations referred to in subsections (a), (b), and (c) shall be as follows:

. . . . . :

(4) Gains and losses from sales or exchanges of capital assets shall be taken into account without regard to the provisions of Section 117 (b). As so computed the amount

deductible on account of such losses shall not exceed the amount includible on account of such gains.

(5) Deductions otherwise allowed by law not attributable to the operation of a trade or business regularly carried on by the taxpayer shall . . . .be allowed only to the extent of the amount of the gross income not derived from such trade or business . . . . .

(26 U. S. C. 1952 ed., Sec. 12p)

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In the Supreme Court of the United States

October Term, 1957

A. L. WASSON and Wife, MATTIE PALLMEYER WASSON, PETITIONERS

v.

UNITED STATES OF AMERICA

On Petition for a Writ of Certiorari to the United States Court of Appeals for the Fifth Circuit

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BRIEF FOR THE UNITED STATES IN OPPOSITION

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In the Supreme Court of the United States

October Term, 1957

No. 1031

A. L. WASSON and Wife, MATTIE PALLMEYER WASSON, PETITIONERS

v.

UNITED STATES OF AMERICA

On Petition for a Writ of Certiorari to the United States Court of Appeals for the Fifth Circuit

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BRIEF FOR THE UNITED STATES IN OPPOSITION

OPINIONS BELOW

The findings of fact and conclusions of law of the District Court (Pet. 37-39; R. 209-216) are not reported. The opinion of the Court of Appeals (Pet. 26-36) is reported at 250 F. 2d 826.

JURISDICTION

The judgment of the Court of Appeals was entered on January 7, 1958. The taxpayers' petition for rehearing was filed on January 15, 1958, and denied

on February 28, 1958. The petition for a writ of certiorari was filed on May 28, 1958. The jurisdiction of this Court is invoked under 28 U.S.C. 1254.

QUESTIONS PRESENTED

Whether under Section 122 of the Internal Revenue Code of 1939, as amended, the taxpayer[1] is entitled to all or any of five claimed adjustments pertaining to the conversion of a 1951 net operating loss into a 1950 net operating loss carry-back deduction:

(1) An additional deduction on the taxpayer's individual 1951 return for sheep purchases, incident to an unrecorded transfer of 508 sheep by Wasson and Carter, a ranching partnership;

(2) An additional deduction on the taxpayer's 1951 return with respect to a wool inventory carried by Wasson and Carter;

(3) An addition to the taxpayer's 1951 net operating loss, by reason of contributions claimed on his individual return for that year;

(4) An alleged right to submit proof of cost depletion not specified in the claim for refund, the Commissioner having made an adjustment under Section 122 (d) (1) of the Internal Revenue Code of 1939 for claimed percentage depletion; and

(5) An alleged Section 122(d)(4) computation error pertinent to the determination of the net operating loss carry-back deduction for the taxable year 1950, based on a claimed failure by the Commis-

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[1] The term taxpayer refers to A. L. Wasson.

sioner to take into account, under Section 117(e) of the 1939 Code, a net capital loss of $28,756.79, which had been carried over from the preceding 1949 taxable year.

STATUTE AND REGULATIONS INVOLVED

Sections 23(e), (o), and (s), 41, 117(b) and (e), and 122(a) and (d) of the Internal Revenue Code of 1939 and Sections 29.41-1, 29.122-3(a), and 29.122-4(a), of Treasury Regulations 111 are set forth in the Appendix, *infra*, pp. 12-17.

STATEMENT

The pertinent facts, as found by the District Court (Pet. 37-38; R. 210-213) and adopted, insofar as here applicable, by the Court of Appeals (Pet. 26-36) are as follows:

This action was brought to recover income taxes paid for the calendar year 1950. On March 15, 1951, A. L. Wasson filed a joint income tax return for the taxable year 1950 for himself and Mrs. Mattie E. Wasson, deceased. This return was amended on September 15, 1953, to show a net income of $85,951.18 and an overpayment of tax in the amount of $27,499.96, based in large measure on a claimed net operating loss carry-back deduction from the subsequent year, 1951, in the amount of $94,820.15. For the year 1951, A. L. Wasson originally filed a separate return, which was later amended, on September 15, 1953, to show a net operating loss of $94,820.15. The amended 1951

return included losses attributable to certain partnership interests, including Wasson and Carter, a ranching partnership in which taxpayer had the the principal interest. (R. 210-211.)

The taxpayer's books and records, including those of Wasson and Carter, did not reflect a definite method nor did they clearly reflect income. Based on evidence submitted by both parties, the taxpayers were on a cash receipts and disbursement basis. (Pet.-37; R. 211.)

A. L. Wasson's books for 1951 showed losses (largely sheep and cattle losses) which he contended were his separate losses and should be used in computing his net operating loss carry-back from 1951 to 1950 (R. 211)[2].

In 1951, there was an unrecorded transfer from the partnership of Wasson and Carter to A. L. Wasson of 508 head of sheep. This resulted in an understatement of sales of the partnership in the sum of $5,924, which had no effect on the personal return of the taxpayer since these sheep would have been included in his closing inventory, thereby reducing the number of sheep sold or lost. (R. 212.)

For the taxable year 1949, A. L. Wasson and his then wife had a net capital loss in the amount of $29,756.79, which, when reduced by the $1,000 capital loss allowable for the year 1949, left a capital loss to be carried forward to the year 1950 in the amount of $28,756.79. For the taxable year 1950, the taxpayer had a long-term capital gain of $48,008.43

[2] This contention, described as Point One in the Court of Appeals, was accepted by that court. (Pet. 26, fn. 1; 36.)

(50% of $96,016.86). Combined with the capital loss carry-forward, this produced a net capital gain for the year 1950 in the amount of $19,251.64. There was no capital loss carry-over to 1951 as the entire amount was absorbed by the 1950 capital gain. (Pet. 38; R. 213.)

On the basis of the above findings, the District Court concluded, so far as is here pertinent:

> The Commissioner has wide discretion in determining the method of accounting where the books do not reflect a definite method or clearly reflect income. The use of inventories by the taxpayer is not conclusive on this question. The Commissioner's finding that the taxpayer was on a cash receipts and disbursement basis is upheld. The accrued expenses were properly disallowed. (Pet. 38; R. 214.)
>
> On the issue of understatement of sheep sales of the partnership of Wasson and Carter, it has been found as a fact that there was an unrecorded transfer from the partnership to the taxpayer of 508 head of sheep. This resulted in an understatement of sales of the partnership with no effect on the personal return of Wasson since these sheep would have been included in his closing inventory, thereby reducing the number of sheep sold or lost. (Pet. 39; R. 215.)
>
> Section 122(d)(4) of the Internal Revenue Code of 1939 does not apply to affect the capital loss carryover from 1949. (Pet. 39; R. 216.)

The Court of Appeals, while it reversed the District Court on an issue not here involved, affirmed its findings on the points raised in this Court (Pet. 36).

ARGUMENT

This case does not warrant further review. No general or important question of federal income tax law is presented. Each issue here raised depends upon the factual context of this particular case. Moreover, there is no conflict of decisions.

1. In his contention under question 1, which concededly constitutes merely "a problem in accounting" (Pet. 9-10), the taxpayer attempts to ascribe unwarranted significance to Finding 14 (Pet. 37-38; R. 212), which approved, in effect, an adjustment of $3,924 made to Wasson and Carter's 1951 sales as a result of the unrecorded transfer of 508 sheep to taxpayer, A. L. Wasson, individually, on November 8, 1951 (R. 14). While the taxpayer does not attack this finding (Pet. 10), he does assert that there should be an additional adjustment to A. L. Wasson's 1951 net operating loss by way of a corresponding increase in purchases by the latter. As the trial court found (Pet. 38), "these sheep would have been included in his closing inventory, thereby reducing the number of sheep sold or lost." The effect of the adjustment was to increase the partnership's sales (a profit and loss item, accounting-wise) and this, in turn, resulted in a corresponding decrease in Wasson's distributive share of the firm's 1951 loss. The error of assuming that the taxpayer's books should be adjusted to reflect the cost of these sheep (Pet. 10-11) appears from the District Court's finding (Pet. 37; R. 211) that Wasson was "on a cash receipt and disbursements basis." No evidence was adduced that

Wasson made any cash outlay that could serve as the basis for the alleged "Purchase of sheep" (Pet. 11) upon which taxpayer's erroneous claim is predicated.

2. Under question 2 (Pet. 12-16), the gravamen of the taxpayer's complaint is that the courts below did not revise the Wasson and Carter partnership's system of tax accounting to make an adjustment in a 1951 item of wool inventory. However, no contention with respect to this belatedly claimed adjustment was made by taxpayer before the District Court. Moreover, Wasson and Carter was not a party to this litigation. Its 1951 operations have relevance, for present purposes, to the extent that adjustments affecting taxpayer's distributive share of its reported 1951 loss were challenged at the trial. In addition to the unrecorded sheep transfer, discussed in connection with question 1, *supra*, such adjustments included the Commissioner's disallowance of accrued taxes, rent, and interest. (Taxpayer's C.A. Br. 2; R. 18, 21, 64.) In disallowing such accrued expenses, the revenue agent had ample justification since the partnership was not the record owner of New Mexico land on the date the accrued taxes became a lien (R. 19-20), accrued rent was not amortized over the leasehold life (R. 21), and no verification could be secured that the accrued interest was even paid (R. 64). Therefore, since no reliable tax accrual method was in effect with respect to these specific disallowances, the Commissioner was clearly empowered, under Section 41 of the 1939 Code (Appendix, *infra*), to disregard the partnership's purported accrual method of accounting to the extent

that it did not "clearly reflect the income." In this regard only was it necessary to disturb Wasson and Carter's regularly employed method of tax accounting. Clearly, as to other phases of the partnership's operations, such as the wool inventory which was not in issue, no duty devolved on the Commissioner to make adjustments. Accordingly, the District Court was correct in finding (Pet. 37) that, whereas "taxpayers were on a cash receipt and disbursements basis", the "books and records * * * of Wasson and Carter, did not reflect a definite method nor did they clearly reflect income." This finding, adequately supported by the facts presented, authorized the exercise of the Commissioner's discretion in disallowing the claimed expenses, and in limiting the adjustments to the issues raised.

3. The taxpayer's claim (question 3 (Pet. 16-18)) to an additional 1951 net operating loss on account of contributions runs contrary to the express provisions of the 1939 Code. Section 23(o) (Appendix, *infra*), permits individuals, whether on a cash or accrual basis, to take a limited deduction (*viz.*, 15 percent of *adjusted gross income*) only for the year in which the contribution is paid. Accordingly, since taxpayer had no adjusted gross income in 1951, the loss year, no statutory basis exists for taking any contributions deduction. The alleged conflict (Pet. 16, 17-18) with *Hughes* v. *Commissioner*, 38 F. 2d 755 (C.A. 10), does not exist. The precise contributions issue, here raised, had there been considered by the Board of Tax Appeals below and decided for the Commissioner for the reasons we rely on here.

Hughes v. *Commissioner*, 15 B.T.A. 215, 219. In reversing the Board, on appeal, the Tenth Circuit did not address itself specifically to the contributions issue but, instead, confined its attention (p. 757) to the question of the meaning of the phrase "trade or business", as used in Section 204(a) of the Revenue Act of 1921, 42 Stat. 227, and concluded (p. 759) that income from the taxpayer's law practice, from salaries and from dividends was not embraced within the meaning of that particular statute.

4. Under question 4 (Pet. 18-21), the taxpayer reiterates a contention, raised both on appeal and on motion for rehearing, against the District Court's ruling sustaining an objection by Government counsel (R. 34) to the introduction of evidence concerning alleged cost depletion attributable to A. L. Wasson on a royalty interest of the Wasson Oil Company, a non-party partnership. This contention is plainly without merit. No claim for cost depletion was set out in the claims for refund. (R. 32-33.) Accordingly, the District Court lacked jurisdiction to consider the problem. *United States* v. *Felt & Tarrant Co.*, 283 U.S. 269; *Real Estate Title Co.* v. *United States*, 309 U.S. 13. Moreover, revenue agent Hawkins, who had been called as the taxpayer's witness, had no knowledge of any cost basis that the taxpayer A. L. Wasson might have had (R. 28), nor was he familiar with any prior revenue reports concerning the estate of A. L. Wasson's first wife, Mattie E. Wasson (R. 28-29).

5. Finally, under question 5 (Pet. 21-25), which is essentially a computation problem, the taxpayer

mistakenly attempts to claim an additional 1950 deduction of $28,756.79 (Pet. 8) on the erroneous assumption that a 1949 net capital loss in that amount[3] constituted (Pet. 3) a carry-over item under Section 117(e)[4] which, allegedly, had not been fully taken into account in making the required Section 122(d)(4) capital gains and losses adjustment[5] to 1950 income incident to computation of the applicable 1951 net operating loss carry-back deduction to that year. As authority for such claim, the taxpayer relies (Pet. 23) essentially on the recent decision in *Weinstein* v. *Commissioner*, 29 T.C. 142, 149. The holding re-

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[3] Under Section 117(e)(1) of the 1939 Code (Appendix, *infra*), this $28,756.79 net capital loss carry-over from 1949 (Pet. 38; R. 213) had initially been applied against 1950 short and long-term capital gain in originally reporting taxpayer A. L. Wasson's tax liability for the latter year, prior to incurrence of the subsequent 1951 net operating loss, which necessitated the computation, under Section 122(d)(4) of the 1939 Code (Appendix, *infra*), of the net operating loss carry-back deduction applicable to the taxable year 1950. According to his 1950 return taxpayer A. L. Wasson had a capital gain for that year of $48,008.43 (50 percent of $96,016.86). The 1949 net capital loss carry-over was thus totally absorbed, producing a net capital gain included in 1950 net income, as shown in the return, in the amount of $19,251.64.

[4] As respects net capital loss carry-overs, Section 117(e)(1) provides, in effect, that a net capital loss may be carried forward to the following five years as a short-term capital loss and offset against a net capital gain for any of such years to the extent that it was not previously used.

[5] Section 122(d)(1) of the 1939 Code insofar as here relevant, provides that gains and losses from sales or exchanges of capital assets shall be taken into account without regard to the percentage limitations of Section 117(b).

ferred to in that case, as applied to the facts of this case, would require that the 1949 capital loss must be considered in computing the gain for 1950 to which the 1951 loss is to be carried back as a deduction. This holding differs materially from the taxpayer's argument that the 1949 loss must be carried forward without any reduction under Section 117(b), or, in other words, in double the amount conceded by the Government. Neither the language of Section 122 (d) (4) nor the holding in *Weinstein* or any other case would require that result.

CONCLUSION

For the reasons stated, the petition for a writ of certiorari should be denied.

Respectfully submitted,

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JUNE, 1958.

APPENDIX

Internal Revenue Code of 1939:

SEC. 23. DEDUCTIONS FROM GROSS INCOME.

In computing net income there shall be allowed as deductions:

* * * * *

(e) *Losses by Individuals.*—In the case of an individual, losses sustained during the taxable year and not compensated for by insurance or otherwise—

(1) if incurred in trade or business; or

(2) if incurred in any transaction entered into for profit, though not connected with the trade or business; or

(3) of property not connected with the trade or business, if the loss arises from fires, storms, shipwreck, or other casualty, or from theft. No loss shall be allowed as a deduction under this paragraph if at the time of the filing of the return such loss has been claimed as a deduction for estate tax purposes in the estate tax return.

* * * * *

(o) [As amended by Sec. 224(a) of the Revenue Act of 1939, c. 247, 53 Stat. 862, and Sec. 8(b) of the Individual Income Tax Act of 1944, 58 Stat. 231] *Charitable and Other Contributions.*—In the case of an individual, contributions or gifts payment of which is made within the taxable year to or for the use of:

* * * * *

(2) A corporation, trust, or community chest, fund, or foundation, created or organized in the United States or in any pos-

session thereof or under the law of the United States or of any State or Territory or of any possession of the United States, organized and operated exclusively for religious, charitable, scientific, literary, or educational purposes, * * *

* * * *

to an amount which in all of the above cases combined does not exceed 15 per centum of the taxpayer's adjusted gross income. * * *

(s) [As added by Sec. 211(a), Revenue Act of 1939, supra] *Net Operating Loss Deduction.*—For any taxable year beginning after December 31, 1939, the net operating loss deduction computed under section 122.

(26 U.S.C. 23.)

SEC. 41. GENERAL RULE.

The net income shall be computed upon the basis of the taxpayer's annual accounting period (fiscal year or calendar year, as the case may be) in accordance with the method of accounting regularly employed in keeping the books of such taxpayer; but if no such method of accounting has been so employed, or if the method employed does not clearly reflect the income, the computation shall be made in accordance with such method as in the opinion of the Commissioner does clearly reflect the income. * * *

(26 U.S.C. 41.)

SEC. 117. CAPITAL GAINS AND LOSSES.

* * * *

(b) [As amended by Sec. 150(c), Revenue Act of 1942, c. 619, 56 Stat. 798] *Percentage Taken Into Account.*—In the case of a taxpayer,

other than a corporation, only the following percentages of the gain or loss recognized upon the sale or exchange of a capital asset shall be taken into account in computing net capital gain, net capital loss, and net income:

100 per centum if the capital asset has been held for not more than 6 months;

50 percentum if the capital asset has been held for more than 6 months.

* * * *

(e) [As amended by Sec. 150(c), Revenue Act of 1942, *supra*,] *Capital Loss Carry-Over.*—

(1) *Method of computation.*—If for any taxable year beginning after December 31, 1941, the taxpayer has a net capital loss, the amount thereof shall be a short-term capital loss in each of the five succeeding taxable years to the extent that such amount exceeds the total of any net capital gains of any taxable years intervening between the taxable year in which the net capital loss arose and such succeeding taxable year. For purposes of this paragraph a net capital gain shall be computed without regard to such net capital loss or to any net capital losses arising in any such intervening taxable years.

* * * *

(26 U. S. C. 117.)

SEC. 122 [As added by Sec. 211(b), Revenue Act of 1939, *supra*, and as amended by Secs. 105(e) and 150(e), Revenue Act of 1942, supra]. NET OPERATING LOSS DEDUCTION.

(a) *Definition of Net Operating Loss.*—As used in this section, the term "net operating loss" means the excess of the deductions allowed by this chapter over the gross income, with the exceptions, additions, and limitations provided in subsection (d).

* * * * *

(d) *Exceptions, Additions, and Limitations*—The exceptions, additions, and limitations referred to in subsections (a), (b), and (c) shall be as follows:

(1) The deduction for depletion shall not exceed the amount which would be allowable if computed without reference to discovery value or to percentage depletion under section 114(b)(2),(3), or (4);

* * * * *

(4) Gains and losses from sales or exchanges of capital assets shall be taken into account without regard to the provisions of section 117(b). As so computed the amount deductible on account of such losses shall not exceed the amount includible on account of such gains.

* * * * *

(26 U.S.C. 122.)

Treasury Regulations 111, promulgated under the Internal Revenue Code of 1939:

Sec. 29.11-1. *Computation of Net Income*—Net income must be computed with respect to a fixed period. * * * It is sufficient that such items, if otherwise properly included in the computation, can be valued in terms of money. The

time as of which any item of gross income or any deduction is to be accounted for must be determined in the light of the fundamental rule that the computation shall be made in such a manner as clearly reflects the taxpayer's income. If the method of accounting regularly employed by him in keeping his books clearly reflects his income, it is to be followed with respect to the time as of which items of gross income and deductions are to be accounted for. * * * If the taxpayer does not regularly employ a method of accounting which clearly reflects his income, the computation shall be made in such manner as in the opinion of the Commissioner clearly reflects it.

Sec. 29.122-3. *Computation of Net Operating Loss in Case of a Taxpayer Other Than a Corporation.*—(a) *General.*—A net operating loss is sustained by a taxpayer other than a corporation in any taxable year if and to the extent that, for such year, there is an excess of deductions allowed by chapter 1 over gross income, both computed with the following exceptions and limitations:

> (1) The deduction for depletion shall not exceed the amount which would be allowable if computed without reference to discovery value or to percentage depletion under section 114 (b) (2), (3), or (4);
>
> * * * *

Sec. 29.122-4 [As amended by T.D. 5963, 1953-1 Cum. Bull. 197] *Computation of Net Operating Loss Carry-Overs and Net Operating Loss Carry-backs.*—(a) *In general.*—The aggregate of any net operating loss carry-overs

and any net operating loss carry-backs to a taxable year shall be the basis of the net operating loss deduction. In order to compute such deduction the taxpayer must first determine the part of any net operating losses for any preceding or succeeding taxable years which are carry-overs or carry-backs to the current taxable year.

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